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THE COMMUNICATOR

DISABILITY INSURANCE IN BUSINESS PLANNING

★ WAGE / SALARY CONTINUATION PLANS

Part II

EVERY EMPLOYER IN AMERICA will probably face this devilish problem:

Two employees are badly injured in an auto accident that occurred on their way to a company training session. One had been with the Company eleven years and the other, two years. Neither can financially sustain themselves on Workers' Compensation Benefits.

PROBLEM: Should the employer continue the paychecks to these desirable employees and who are wanted back at work? Should the employer continue the pay of the eleven year employee and not the two year employee? Should the employer relate to them as does the IRS and brand them as Ex-Employees and pay them not at all? No payments made after the accident will be tax deductible because there was no Tax Qualified Wage / Salary Continuation Plan in effect.

EVERY COMPETENT BROKER can provide a desirable solution to the problem.

Employers are required to provide some disability income benefits:

- ★ They pay for Workers' Compensation insurance, and
- ★ They make sizable contributions to each employee's Social Security account. These are modest and limited benefits that are subject to income tax liability for the employee because of being paid in whole or in part by the employer.

- ★ Employers in California, New York, New Jersey, Rhode Island, Hawaii and Puerto Rico must provide payroll deduction for and enroll all employees in the State Disability Insurance plan to provide “off-the-job” coverage that is not included in workers’ compensation plans.

These Social Insurance benefits are usually inadequate to maintain an employees lifestyle. Some Employers provide Group Disability for all employees. Other firms provide disability payroll deduction for the convenience of employees in providing supplemental disability insurance benefits for themselves.

Group Short Term (STD) and Long Term (LTD) Disability plans require participation by all employees and payment of the premium by the employer. Multi-Life or individual plans may be paid in full, or in part, by the employer. Typically the employer provides the convenience of payroll deductions for any contributions made by the employees. Sponsorship of a payroll deduction plan may also benefit the employee because of multi-life discounts.

The employer may be selective in paying premiums for one, or for some employees without concern of discrimination issues. In the pursuit of providing wage / salary continuation benefits a very important factor is often overlooked. A plan installed without qualification is in danger of creating substantial tax problems for the employer.

LTD Group and Individual Plans typically carry a 90 or 180 day elimination period. There is generally temptation by benevolent management to continue wages or salaries through the elimination period of the disability plan. Warning! Without prior tax qualification such payments are not deductible as a business expense. Even if STD is added to plug the LTD deductible any payment other than unused sick leave and vacation time become payments to an *EX-EMPLOYEE* and such payments are non-deductible. The **IRS** considers a person who is disabled and unable to work to be an *EX-EMPLOYEE*.

THE SOCIAL INSURANCES PROVIDED BY EMPLOYERS

Workers' Compensation

Covers medical services to treat job related injuries or illness that is directly related to ones job, temporary disability payments, permanent disability payments, vocational rehabilitation and a death benefit for survivors in case of a fatal injury.

Medical Care – Full

Temporary Disability – First day coverage @ 2/3 of regular pay, up to \$490 per week, until employee returns to work or is pronounced permanently disabled.

Permanent Disability – First day coverage @ 2/3 of pay, up to \$490 per week for life.

Rehabilitation – up to 2/3 of regular pay not to exceed \$246 per week and a maximum of \$16,000. Funded by employer contributions.

For complete information on Workers' Compensation see

<http://www.dir.ca.gov/DWC/basics.htm>

Social Security Disability

Payable following a six month waiting period for as long as life. The benefit amount is determined by age, earnings or credits and dependent situation. It can pay as much as \$1,815 to \$2,747 per month. These Social Security Benefits may be prorated. In case of SDI and Workers' Comp, benefits from all sources cannot exceed 100% of compensation at time of disablement. The Social Security Benefit will be adjusted downward when combined disability benefits equal 80% of prior earnings. Funded by contributions from employee and employer

For complete information on Social Security Benefits see

<http://www.ssa.gov/pubs/10029.html>

State Disability Insurance (SDI) Mandatory and transportable.

(California's SDI) pays a weekly benefit following a 7-day waiting period. It pays for as long as 52 weeks in amounts ranging from \$50 to \$490 depending on the income level of the employee. The amount of the weekly benefit is calculated on a base period of earnings over a 12-month period and usually is 55% - 60% of earnings in the highest quarter of one's base period.

The plan pays in the event of sickness, or injuries sustained off the job. The intent is to provide benefits not covered by Workers' Compensation which covers only on-the-job injuries. Funded by employee payroll deductions.

For complete information on SDI see

<http://www.edd.ca.gov/diind.htm>

OVERVIEW OF WAGE / SALARY CONTINUATION PLANS

Treasury Regulations and case law indicate that **IRS** will contest the deductibility of any payments made to a disabled employee unless:

1. The plan was set up in advance of the disability of any covered employee
2. The Plan was not established in contemplation of the immediate or impending disability of any covered employee
3. The details of the Plan have been made known to all covered employees.
4. The details of the Plan are provable

Insurance is not necessary for there to be a Plan, but an insured Plan provides these important advantages:

1. Clearly defines disability
2. Documentation of the Plan details
3. Supplies the funds to carry out the Plan
4. Guarantees the Plan
5. Frees salary of disabled employee for other use
6. Desirable choices: Tax-deductible premium to the employer if paid by employer or tax-free benefits to the employee if funded by employee.
7. Eliminates need for "sterile" reserves.
8. Eliminates the possibility of an **IRS** challenge of payments to a disabled employee.

Treasury Regulations 1.105-5 states that existence of a policy of insurance in prima facie evidence of a Plan.



Helping Employers understand the potential tax liability resulting from non-qualified wage / salary continuation provides an excellent public relations opportunity for brokers. If a Broker sells insurance for this purpose the Employer and Employees are made more secure to withstand the problems related to an employee's disability.

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